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No. 96-831

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1996

EDMUND M. MAHERN, TRUSTEE,
FOR MERCHANTS GRAIN, INC.,
*Petitioner*,

v.

MARK AND CHRIS ADKINS, ET AL.,
*Respondents*,

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit**

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# BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED FOR REVIEW

1. Did the Seventh Circuit correctly interpret Section 926.021 of the Ohio Revised Code?

2. Did the Seventh Circuit correctly determine that the Trustee may not avoid the lien created by Section 926.021 of the Ohio Revised Code under the narrow avoidance powers created by 11 U.S.C. §§ 545 and 547?

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## STATEMENT OF THE CASE

In most respects, respondents agree with the trustee's characterization of the facts and case. A few clarifications, however, are in order.

Merchants Grain, Inc. ("MGI") operated grain warehouses in several states, including Ohio, and served farmers from many states, again including farmers located in Ohio. Contrary to the assertions of the Trustee, moreover, MGI offered a myriad of grain marketing alternatives, including bailment grain, delayed price grain, basis contracts, cash sales, and contract grain. The respondent farmers took advantage of each of these alternatives.

Under Ohio Revised Code ("O.R.C.") 926.06, a grain elevator that wishes to act as a licensed handler must comply with certain financial responsibility requirements. In accordance with this obligation, MGI submitted its annual financial statement to the Ohio Department of Agriculture in August 1990. The Department promptly analyzed the statement and determined that MGI did not meet the statutory net worth requirements. *See* O.R.C. 926.06(B). Despite notice of the problem, MGI had not cured the deficiency by November 1990. Because the fall harvest was well underway by that time, the Department conditionally suspended MGI's license. *See* O.R.C. 926.10. MGI thus remained open, operating under strict conditions. Contrary to the Trustee's suggestion, these conditions did not include the requirement that MGI use grain delivered to its Columbus elevator to pay only Ohio farmers. The Trustee also incorrectly suggests that Ohio's statutory lien protects only Ohio farmers. The lien protects all *depositors*, wherever situated, who deposit grain at licensed elevators in Ohio, as the Seventh Circuit correctly found. Petition at 20a.

In view of the conditional suspension, the Department increased its oversight of MGI. In December 1990, MGI failed to honor a check to a federal agency, and as a result the United States Department of Agriculture suspended MGI's federal license. Thereafter MGI voluntarily closed its doors, and the Department suspended MGI's Ohio license on January 7, 1991.

The Department negotiated with MGI to liquidate the grain on hand at the Columbus, Ohio facility and to use the proceeds to pay the facility's depositors. The parties agreed on terms in January 1991. Under the agreement, MGI liquidated the grain and deposited the proceeds into three escrow accounts; all withdrawals required the signatures of the Department and MGI. Depositors were paid from the respective escrow accounts, depending on the type of grain marketing transaction the depositor had used. All payments to depositors were completed by March 1991.

## REASONS FOR DENYING THE WRIT

The holding in this case rests on an interpretation of state law. O.R.C. 926.021 permissibly establishes a statutory lien on grain deposits at Ohio licensed grain elevators to secure payment to in-state and out-of-state farmers. So long as the lien properly arises on deposit, as all three of the lower federal courts found and as is in fact true under Ohio law, the Trustee cannot avoid the lien under federal law. *See* 11 U.S.C. §§ 545, 547. Accordingly, because the timing of the attachment of the lien is a matter of state law and state law alone, the writ should be denied.

The Trustee goes to great lengths in arguing that all three lower courts misconstrued various bankruptcy provisions and thereby improperly prevented the Trustee from avoiding Ohio's statutory lien on grain deposits. The

truth is more straightforward. In order for the Trustee to be empowered to avoid a statutory lien, the lien must arise as a result of the debtor's insolvency. The lien created by O.R.C. 926.021 does not.

As the Seventh Circuit (Cummings, Bauer, *Manion*) correctly found, 11 U.S.C. 547 grants the trustee limited avoidance powers to get back money that was transferred to creditors shortly before a bankruptcy filing. Petition at 7a. That authority, however, does not permit the trustee to ignore statutory liens that treat grain-depositing farmers as secured creditors. Thus, "[t]he trustee's ability to employ section 547(b) to avoid the transfers rises or falls on whether the lien created by Ohio statute was both valid under state law and not prohibited under the Code." *Id.* at 10a. *See McKenzie v. Irving Trust Co.*, 323 U.S. 365, 370 (1945) (looking to state law to determine the extent of property interest under lien).

Not only was the Seventh Circuit correct that this determination turns on state law, but it also was correct in concluding that the lien was valid in this instance. Under O.R.C. 926.021(B), a lien is created on agricultural commodity assets. The lien arises on delivery of the grain to the elevator. O.R.C. 926.021(C). In the event of an elevator failure, exclusive power to enforce the lien transfers to the Director of Agriculture who may liquidate the grain and allocate the proceeds in accordance with the statute's terms. O.R.C. 926.021(D). Nothing in these subsections, or in any of the other provisions of the section, supports the Trustee's naked assertion that the lien attaches only to the assets of an insolvent elevator; the lien arises on deposit. Nor has the Trustee cited a single federal or state court that has embraced this interpretation. At all events, this interpretation (right or wrong) rests on state, not federal, law.

No less flawed is the Trustee's contention that the Seventh Circuit erred in determining that 11 U.S.C. 545 does not permit the Trustee to avoid the farmers' statutory lien. Unlike section 547, to be sure, this provision permits the Trustee to avoid "the fixing of a lien," as opposed to granting the Trustee power to avoid "a statutory lien." But the difference is of no help to the Trustee. Once again, the sole question created by the federal statute is one of timing under state law: Does O.R.C. 926.021 create a lien for the amount of the grain "contemporaneously with delivery"? *See* Petition at 18a-19a. If it does, then MGI acquired the grain subject to the lien; if it does not, then the Trustee *might* be able to avoid the fixing of the lien. In this instance, the lien plainly arose under state law on the delivery of the grain, meaning that the lien was not avoidable under section 545. Indeed, as the Seventh Circuit correctly recognized, this state law analysis parallels to a large degree the one conducted in determining whether section 547 applies. Petition at 19a.

Apparently recognizing the impediment to further federal court review of this essentially state law issue, the Trustee tries to create a substantial federal question where there is none. He argues that the lower court's interpretation of the relationship between section 545 and section 547 differs from that of four other courts and therefore is certworthy. While the Seventh Circuit's examined conclusion differs from the assumptions of four other circuits, as the court itself acknowledged, *see* Petition at 17a n.4, this fact alone does not warrant further review of the issue.

As an initial matter, the Seventh Circuit relied on a decision of this Court in reaching its conclusion. In *Farrey v. Sanderfoot*, 500 U.S. 291 (1991), the Court noted that

section 522(f) of the Code, like section 545, focuses on the "fixing of liens," not the avoidance of liens. And it gave this textual distinction meaning by concluding that the trustee (the debtor, really) must have "had the property interest to which the lien attached at some point *before* the lien attached to that interest" in order to have any avoidance power. 500 U.S. at 296. In this instance, because the debtor (MGI) did not have a property interest in the grain before the statutory lien attached under state law, the trustee lacked avoidance authority under section 545 and therefore authority to get the money back under section 547.

Nor does this conclusion create the kind of lower-court conflict that warrants certiorari. In addition to being supported by *Farrey*, not one of the four lower-court decisions took the time to analyze the interrelation of section 545 and 547. And, from all that appears in the decisions themselves, no party took the time to analyze the relationship either. All you have, in other words, are the unexamined assumptions of four courts that section 545 permits the avoidance of liens as opposed to the avoidance of the fixing of liens.

These assumptions are *dicta* as well, because in each instance the courts rejected the lien avoidance argument when all was said and done. In *In re Walter*, 45 F. 3d 1023 (6th Cir. 1955), the court held that the Trustee could not avoid a tax lien that attached to the debtor's tractor. In *In re LMS Holding Co.*, 50 F. 3d 1526 (10th Cir. 1995), the court held that the debtor in possession could not avoid a tax lien. And in *In re Loretto Winery Ltd.*, 898 F. 2d 715 (9th Cir. 1990), and *In re Woods Farmers Cooperative Elevator Company*, 946 F. 2d 1411 (8th Cir. 1991), the courts refused to allow the Trustees to avoid statutory liens on grapes and on grain respectively. Thus, even giving the Trustee the benefit of the doubt on its assertions of a split, it makes sense to let the

issue percolate in the lower courts to determine whether other courts reject or, as seems more likely, adopt the well-reasoned analysis of the Seventh Circuit on the relationship between sections 545 and 547. That is particularly true here because under Ohio law it remains exceedingly unlikely that the adoption of the Trustee's analysis would make a difference in this case. For even if section 545 permitted the avoidance of a lien, as opposed to the fixing of a lien, the lien was still valid under state law and therefore insulated from the Trustee's avoidance powers.

Finally, the Trustee complains that the Seventh Circuit's opinion "states" that "property subject to a lien is not property of the estate." Petition at 20. No citation is offered to back up this interpretation of the opinion. And none would seem to be able to do so -- particularly if the Trustee means to challenge a holding in the case. All the Seventh Circuit was saying was this: The trustee's ability to avoid the transfers "rises and falls" on whether the Ohio statutory lien was valid. *Id.* at 10a. That conclusion is correct and simply does not warrant further review.

## CONCLUSION

For the foregoing reasons, the Court should deny the writ.

Respectfully submitted,

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# APPENDIX

[§ 926.02.1] § 926.021 Liens on agricultural commodity assets of failed handler; priority.

(A) As used in this section:

(1) "Claimant" means a person who is unable to secure satisfaction of financial obligations due from an agricultural commodity handler.

(2) "Failure" means any of the following involving an agricultural commodity handler:

(a) An inability to financially satisfy claimants;

(b) A public declaration of insolvency;

(c) A revocation of license with outstanding indebtedness to claimants;

(d) Nonpayment in the ordinary course of business where a good faith dispute does not exist;

(e) No application for license renewal;

(f) Denial of license renewal;

(g) Voluntarily surrendering a license.

(3) "Agricultural commodity assets" involving a failed agricultural commodity handler mean any of the following:

(a) All agricultural commodities owned or stored, including agricultural commodities in transit shipped by the failed handler but not yet paid for;

(b) Redeposited agricultural commodities;

(c) Proceeds from the sale of agricultural commodities due or to become due;

(d) The equity less any secured financing directly associated therewith in assets in hedging or speculative margin accounts held by commodity or security exchanges or dealers representing the exchanges, and any moneys due or to become due less any secured financing directly associated therewith from any transactions on the exchanges;

(e) Any other unencumbered funds, property, or equity in funds or property, wherever located, that can be directly traced to the sale of agricultural commodities by the failed handler, provided both that the funds, property, or equity in funds or property shall not be considered to be encumbered unless the encumbrance results from good and valuable considerations advanced by any secured party on a good faith basis and that the encumbrance is not the result of the taking of funds, property, or equity in funds or property as additional collateral for an antecedent debt;

(f) Any other unencumbered funds, property, or equity in assets.

(B) A lien shall exist on all agricultural commodity assets of a failed agricultural commodity handler in favor of any of the following:

(1) Claimants, including lenders, who possess receipts covering grain owned or stored by the handler;

(2) Claimants who possess written evidence of ownership other than a receipt disclosing a storage obligation of the handler, including tickets;

(3) Claimants who surrendered receipts as part of an agricultural commodity sales transaction but were not fully paid for the agricultural commodity and the handler failed within twenty days after the surrender;

(4) Claimants who possess any other written evidence of the sale of agricultural commodities to the failed handler for which they were not fully paid.

(C) The lien which shall secure all claims described in division (D) of this section, shall arise at the time of the delivery of the agricultural commodity for sale, commencement of the storage obligation, or when funds are advanced by the lender, and shall terminate when the liability of the agricultural commodity handler to the claimant is discharged, provided that the priority of each lien among the respective claimants shall not relate to the date the claim arises but shall be governed by the priorities established in division (D) of this section. The lien claims of all claimants shall be considered to be assigned by operation of this section to the department of agriculture, and in the event of a failure and subsequent liquidation, the lien shall transfer over to assets or proceeds of assets either received or liquidated by the department of agriculture.

(D) In the event of a failure, the director of agriculture shall enforce the lien claims and allocate the proceeds as follows:

(1) First priority against all agricultural commodity assets shall be the following:

(a) Claimants, including lenders, who possess receipts covering grain owned or stored by the agricultural commodity handler;

(b) Claimants who possess written evidence of ownership other than receipts disclosing a storage obligation of the handler, including tickets;

(c) Claimants who surrendered receipts as part of an agricultural commodity transaction but were not fully paid for the agricultural commodity and the handler failed within twenty-one days after the surrender.

(2) Second priority against all agricultural commodity assets shall be to claimants who possess written evidence of the sale of an agricultural commodity, including but not limited to tickets, delayed price agreements, or similar agricultural commodity delivery contracts who completed delivery and pricing within thirty days immediately prior to the failure of the handler.

(3) To the extent not necessary to satisfy first and second priority claimants, all other claimants who possess written evidence of the sale of agricultural commodities to the failed handler shall participate in the pro rata distribution of the remainder of the agricultural commodity assets in an amount not to exceed the value of their claim.

(E) In the event that any adversary proceeding is commenced to recover agricultural commodity assets upon which the lien imposed in this section is imposed and the department of agriculture declines to enter the proceeding, the director of agriculture, upon application to him by any claimant, shall assign to the claimant the applicable lien to permit the claimant to pursue his lien in the adversary proceeding to the extent the action will not delay the resolution of the proceeding, the prompt liquidation of the assets, or the ultimate distribution of the assets of all claimants.

§ 926.06 Issuance of licenses.

(A) The director of agriculture may issue a handler's license, or renewal thereof, upon the payment of the prescribed application fee, if the director is satisfied that the applicant meets the standards of financial responsibility required under this section and has complied with this chapter and the rules adopted under it.

(B) Each applicant for a handler's license, or renewal thereof, shall have and maintain current assets equal to or greater than current liabilities and a total net worth of at least ten cents per bushel for the total number of bushels of agricultural commodities that he handled during the immediately preceding twelve-month period to cover any indebtedness arising from his operations as a licensed handler. If an applicant is applying for a handler's license for the first time and did not handle any agricultural commodities during the immediately preceding twelve-month period, he shall have an allowable total net worth of at least twenty-five thousand dollars for that purpose. No person shall be licensed as a handler unless he has an allowable total net worth of at least twenty-five thousand dollars. Any deficiency in required total net worth may be compensated for by an indemnity agreement executed by a person pledging personal assets for the benefit of commodity creditors should the licensed handler default in his obligations to the creditors; a bond issued by a corporate surety company that is authorized to do business under the laws of this state; or, at the director's discretion, an irrevocable letter of credit issued by a bank or other lending institution that is authorized by this state or the United States to issue such letters of credit and is subject to service of process in this state for any suit on the bond or letter of credit. A bond shall be made to the treasurer of the state of Ohio to be deposited in the

agricultural commodity depositors fund created under section 926.16 of the Revised Code for the benefit of any person who may be injured by the handler's failure to meet obligations arising under this chapter. A letter of credit shall be issued for the benefit of the department of agriculture and the agricultural commodity depositors fund.

In determining total net worth, credit may be given for fixed assets such as buildings, machinery, and equipment, in the amount of the insured value of such assets under a policy of insurance against loss or damage or, at the discretion of the director, in the amount of their current market value as determined by an accredited rural appraiser or an appraiser certified by the American appraisal institute. The appraiser shall be completely independent of any relationship with the handler. Capital stock shall not be considered a liability for the purpose of determining total net worth. Regardless of the total number of bushels of agricultural commodities that he handled during the immediately preceding twelve-month period, an applicant's total net worth need not exceed three hundred thousand dollars.

(C) In order for the director to determine if an applicant meets the standards of financial responsibility required under division (B) of this section, the applicant for a handler's license, or renewal of a handler's license, shall submit a current financial statement prepared by a qualified person who is not directly associated with the applicant's business. The financial statement shall consist of a balance sheet showing the current and deferred assets and liabilities of the applicant, a statement of income, a statement of retained earnings, a statement of changes in financial position, and whatever notes are sufficient to explain the details contained in the financial statement.

The financial statement accompanying an applicant's original application shall show a statement closing date that is within six months of the date of application. Thereafter, the applicant applying for renewal shall submit an annual statement not later than ninety days after the close of his business year.

The director may require an applicant for a handler's license, or renewal of a handler's license, to submit a financial statement prepared by a certified public accountant licensed under the laws of this state, and may require the attachment to the statement of the accountant's opinion of the applicant's financial status based on his examination of the records conducted in accordance with generally accepted auditing standards if the director determines that the first financial statement submitted under this division is incomplete or otherwise unsatisfactory.

(D) The director may prepare and publish statistical abstracts of information obtained under this section without disclosing details that would identify a particular applicant with particular statistics. Such information is otherwise confidential for purposes of section 102.03 of the Revised Code, and records of the department of agriculture containing such information are not otherwise public records under section 149.43 of the Revised Code.

§ 926.10 Suspension or refusal of license.

The director of agriculture may by order refuse to grant or may suspend or conditionally suspend a handler's license, without prior hearing, when he determines that there is reasonable cause to believe that the applicant or licensee:

(A) Has failed to maintain the insurance coverage required under section 926.07 of the Revised Code;

(B) Has failed to maintain accurate and complete records and accounts as required under section 926.11 of the Revised Code;

(C) Has failed to charge, collect, or remit the fee required under division (B) of section 926.16 of the Revised Code;

(D) Has refused to allow the director or his authorized representative to examine, at a reasonable time, his accounting records, accounts, agricultural commodity inventories, or warehouse;

(E) Does not have in his possession sufficient agricultural commodities to cover the outstanding receipts or tickets issued or assumed by him under bailment agreements;

(F) Has issued a receipt in violation of this chapter or any rules adopted under it;

(G) Does not have the net assets specified in division (B) of section 926.06 of the Revised Code or has failed to obtain a bond or other protection for any deficiency in required net assets as provided in that division;

(H) Does not have his obligations for agricultural commodities purchased under delayed price agreements secured or represented as required under division (B) or (C) of section 926.29 of the Revised Code.

The applicant or licensee to whom a denial or suspension or conditional suspension order is issued shall be afforded a hearing in accordance with Chapter 119. of the

Revised Code, after which the director shall issue or deny the license applied for in the pending application or reinstate or revoke the suspended or conditionally suspended license. The director may suspend or conditionally suspend or revoke a license after a hearing held in accordance with Chapter 119. of the Revised Code for any other violations of this chapter or any rules adopted under it.

The director shall cause a notice to be posted on the property of a person whose license has been suspended, conditionally suspended, or revoked stating the limitations or restrictions imposed on the person in the handling of agricultural commodities as a result of the suspension, conditional suspension, or revocation. The notice shall not be removed from the property without written authorization from the director.